Bureau of Competition
FEDERAL TRADE COMMISSION
WASHINGTON, D.C. 20580

March 17, 1986

Michael A. Duncheon, Esquire
Hanson, Bridgett, Marcus, Vlahos & Stromberg
333 Market Street, Suite 2300
San Francisco, California 94105

Re: Request for Advisory Opinion

Dear Mr. Duncheon:

You have requested an opinion letter from the staff of the Bureau of Competition concerning activities proposed to be undertaken by your client, a preferred provider organization (PPO), whose identity you have not disclosed in order to avoid possible competitive disadvantage.

Specifically, you have asked whether proposed action by the PPO in negotiating contracts with third-party payers, which establish the price at which health care services may be purchased by such payers through the PPO, would constitute a per se violation of Section 1 of the Sherman Act as "price-fixing." 1/ In this regard, your client proposed that its PPO providers agree to accept as full payment, for health care services provided to enrolled patients, prices that are negotiated by the PPO with group purchasers who choose to do business with it. There will be no agreements, express or implied, among the participating providers regarding the prices that the providers will charge to any patients, beneficiaries, or purchasers not contracting through the PPO.

According to the information you have provided, your client is an incorporated joint venture of a limited number of hospitals and physicians in two counties in California. Your client's board of directors consists of equal numbers of hospital and physician representatives. Its shareholders are 16 nonprofit hospitals and 16 physician organizations, called Physician Practice Groups, or "PPGs," comprised of fee-for-service physicians who are members of the shareholder hospitals' respective medical staffs. The 16

1/ Although the Commission does not enforce the Sherman Act, conduct that violates the Act is an "unfair method of competition," and can be prevented by the Commission under § 5 of the Federal Trade Commission Act, 15 U.S.C. § 45 (1982). See FTC v. Cement Institute, 333 U.S. 683, 691 (1948).

participating hospitals represent 16.27 percent of the licensed acute care hospital beds in the two counties, and the approximately 2,500 physicians eligible to participate in the program through the 16 PPGs represent about 10.12 percent of the physicians in those two counties. Each of your client's 32 shareholders has purchased 100 shares of common stock in your client at a cost per shareholder of $10,000.00, in order to provide your client with capital for organization and operation.

Each shareholder hospital or PPG will enter into a participation agreement directly with your client. The 16 shareholder PPGs will also enter into participation agreements with individual physicians. In addition, your client may also enter into participation agreements with certain hospitals and professional practice groups that are not shareholders in your client, "as necessary to achieve the desired geographical dispersion and accessibility for the . . . Network." Participating providers in the network will not be prohibited from doing business with other programs.

Your client proposes to negotiate contracts with group health care purchasers or third-party payers, including insurance companies, self-insured employers, union trusts, health maintenance organizations, and health care service plans, whereby your client will provide a "'network' of health care services . . . accessible over a broad geographic area and which includes both a hospital and a physician component." These contracts will, in effect, establish the prices at which such purchasers may purchase contract health care services through your client from its participating hospitals and physicians, and will offer "preferred" rates to such purchasers.

You state that your client's "fundamental business purpose" is to "compete successfully in the market for the sale and delivery of health care services to group health care purchasers," and that the participating hospitals and physicians have "partially integrated marketing, contracting, quality assurance, and utilization review functions." You also state that your client's participants "will share the risk in marketing 'preferred' health care services on a contract basis to group health care purchasers in competition with other PPOs, other hospital systems, and other hospitals and physicians." In addition, you state that your client "will engage in competition with existing insurance companies, health care service plans, and other alternative delivery systems such as Health Maintenance Organizations . . . ."

After review of the proposed plan of operation for the PPO, we have concluded that we cannot provide you with an advisory opinion with respect to whether your client's proposed negotiation over price on behalf of its participating providers would constitute a violation of Section 1 of the Sherman Act or of Section 5 of the Federal Trade Commission Act. As explained below, certain factual determinations not appropriately made in the context of the advisory opinion process would be necessary in order to make a determination as to whether or not the proposed conduct would be _per se_ illegal or would otherwise be likely to be illegal.

It appears that at least some, and perhaps many, of your client's participating providers are, and will continue to be, competitors of one another. For example, each PPG comprises fee-for-service physicians who practice at the same hospital. Each PPG, therefore, appears to be a combination of competitors. Since your client's participating providers are its shareholders and apparently select its board of directors it also appears that your client is a form of horizontal combination among competitors. 2/ _See_ _United States v. Sealy, Inc._, 338 U.S. 350, 352-54 (1967). _See also_ Federal Trade Commission, Enforcement Policy With Respect to Physician Agreements to Control Medical Prepayment Plans, 46 Fed. Reg. 48982, 48985-86 (1981).

Horizontal agreements among competitors regarding the price at which those competitors will sell their products or services are inherently suspect under the antitrust laws, and, as the Supreme Court has noted, are "among those concerted activities that the Court has held to be within the _per se_ category." _Broadcast Music, Inc. v. Columbia Broadcasting System, Inc._, 441 U.S. 1, 8 (1979). However, "easy labels do not always supply ready answers," _id._, and the _per se_ condemnation of price fixing extends only to those arrangements that are "'plainly anticompetitive' and likely without 'redeeming virtue.'" _Id._ at 9. Thus, while naked horizontal price restraints by competitors are _per se_ illegal, such treatment is not appropriate where, even

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2/ At one point you state that your client's "participating providers operate for the most part in discrete geographic submarkets, and there is little actual competition between them now." We presume this statement refers only to hospital participating providers since each PPG would comprise physicians practicing independently at the same hospital. Even with regard to participating hospitals, however, these hospitals were not specifically identified, and no data -- _e.g._, patient origin information -- were provided in support of your conclusory statement that there is little competition among them. Of course, if it were shown that none of your client's participating providers in fact competes with any other, no substantial antitrust price-fixing issue would be raised.

though prices are literally fixed among two or more competitors, the setting of prices is ancillary and reasonably related to an overall procompetitive joint venture or new enterprise.

The Supreme Court applied this principle in the Broadcast Music case where it declined to apply per se treatment to a joint licensing arrangement pursuant to which an association of competing composers, authors, and music producers established prices at which the members' musical works would be licensed. The Court found that the particular nature of the product -- copyrighted music -- and the virtual impossibility of individual use negotiations or policing of the unauthorized use of copyrighted materials required use of a blanket licensing concept, encompassing an agreement as to price, if there was to be a market at all for the product. Id. at 18-21, 23. The Court concluded that the blanket licensing arrangement had "certain unique characteristics," and created, "to some extent, a different product." Id. at 22. The Court subsequently characterized its holding in that case as a finding that "a joint selling arrangement may be so efficient that it will increase sellers' aggregate output and thus be procompetitive." National Collegiate Athletic Association v. Board of Regents of University of Oklahoma, 104 S. Ct. 2948, 2961 (1984) ("NCAA").

In the NCAA case, the Court found that per se treatment was not appropriate in a situation where some horizontal restraint was required if a product was to be available at all. NCAA, 104 S. Ct. at 2960. In that case, the Court considered the legality of restrictions on price and output of televised college football games, found that the marketing and sale of league sports inherently required some horizontal agreement among competitors, and determined that rule-of-reason analysis was appropriate to consider the legality of particular restraints. The Court noted that "a restraint in a limited aspect of a market may actually enhance marketwide competition." NCAA, 104 S. Ct. at 2961-62. The Court found, however, that the challenged restraints on price and output were not integral to the legitimate and procompetitive goals of the NCAA in offering televised college football. Under the rule of reason, the Court rejected petitioners' proferred justifications and found the restraints illegal. 3/ While recognizing that a joint selling arrangement may "mak[e] possible a new product by reaping

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3/ Once the Court found an agreement not to compete in terms of price or output, its "rule of reason" analysis was limited to consideration of the defendant's justifications for the challenged restraints. In the absence of a valid justification, the NCAA's conduct was deemed to be unlawful without proof of its market power. NCAA, 104 S. Ct. at 2965, 2967.

otherwise unattainable efficiencies," the Court found that the NCAA had failed to demonstrate such efficiencies. NCAA, 104 S. Ct. at 2967 (quoting Arizona v. Maricopa County Medical Society, 457 U.S. 332, 365 (1982) (Powell, J., dissenting)).

In Arizona v. Maricopa County Medical Society, 457 U.S. 332 (1982), the Supreme Court addressed the legality under the antitrust laws of an arrangement whereby a group of competing physicians had jointly agreed, through a foundation for medical care, on maximum prices at which they would sell their services to subscribers of health insurance programs "approved" by the foundation. The foundation for medical care also reviewed the medical necessity and appropriateness of treatment rendered by its members for such subscribers, and acted as an "insurance administrator" by drawing checks on insurance company accounts to pay the physicians for covered services rendered to subscribers. In holding the price agreement per se illegal, the Supreme Court specifically rejected the argument that the foundation arrangement created a new product, as in Broadcast Music, and therefore should be evaluated under the rule of reason:

> The members of the foundations sell medical services. Their combination in the form of the foundation does not permit them to sell any different product . . . . The agreement under attack is an agreement among . . . competing doctors concerning the price at which each will offer his own services to a substantial number of consumers . . . . [The] fee agreements . . . fit squarely into the horizontal price-fixing mold.

457 U.S. at 356-57 (footnote omitted). The Court further found that there was no reason to believe that any efficiency savings of the arrangement would be "sufficiently great to affect the competitiveness" of foundation-approved insurance plans. The Court stated that it was "entirely possible that the potential or actual power of the foundations to dictate the terms of such insurance plans may more than offset the theoretical efficiencies upon which the respondents' defense ultimately rests." Id. at 353-54. 4/

4/ In this connection, the Court noted that the price-setting arrangement involved a group of physicians with substantial power in the market for medical services. 457 U.S. at 354 n.29.

In determining that no new product was being sold through the combination, the Court stressed that there was no meaningful integration, such as pooling of capital or sharing of risk of loss, among the competing participants. Id. at 356. Further, the Court found that the fixing of prices by the competing physicians was not necessary to the achievement of the purported goals of the foundation. Id. at 352-54, 356. Rather, the same goals could be accomplished if prices were determined other than by agreement among the competing physicians.

The Court's holdings in Maricopa and in its other decisions articulating appropriate antitrust analysis of joint ventures of competitors dictate that certain fundamental questions regarding your client's proposed conduct would have to be answered in order to determine whether the conduct would be illegal. 5/ It does not appear that these questions can be answered adequately in the context of the advisory opinion process on the facts available, and issuance of advisory opinions is not appropriate when an informed opinion can be made only after extensive investigation or collateral inquiry. Commission Rules of Practice § 1.1(b).

First, you state that your client will be offering a "new product" in that the PPO will "offer a guaranteed per-unit price for health care services, coupled with procedures designed to control the number of units to be utilized." It is not clear, however, without additional fact-finding and analysis, that the arrangement in fact involves a new product or that it creates efficiencies so great as to distinguish it from plans like that in Maricopa. As was discussed above, the Supreme Court found in Maricopa that horizontal agreement by physicians as to maximum prices was *per se* illegal in the context of a program where the physicians guaranteed that those maximum prices would be accepted as full payment by the physicians, and the program likewise provided utilization controls. You state that the providers in your client's proposed PPO have, to a certain extent, integrated their operations and that they will contribute financially to the

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5/ You have requested guidance with respect to whether your client's proposed conduct would be *per se* illegal. As the foregoing discussion makes clear, conduct appearing on its face to impose a restraint on price competition or output can be summarily condemned under the rule of reason if no valid justification for it exists, even when the context of the practice makes *per se* treatment inappropriate. We have attempted, therefore, to provide guidance on the appropriate antitrust analysis of your client's proposed conduct without regard to the label that might be applied in the course of the analysis.

venture. Yet, they apparently will continue to be competitors of each other in offering their services, except to the extent price competition may be lessened. While such factors as sharing the risk of loss and potential for profit of a firm competing in a market are important in determining whether a new product is being offered, it is not clear, without more, that the limited "pooling of capital," 6/ joint marketing, and other claimed manifestations of integration proposed by your client would be sufficient to distinguish the proposed plan from one like that in Maricopa, where the Court found that no new product was offered. 7/

Second, even if it were determined that the proposal involved a new product or an exceptionally efficient joint selling or marketing arrangement, the question would remain whether the price-setting aspect of the proposed plan was sufficiently related to the legitimate purposes and operations of the program. Although you state that without the proposed price-setting mechanism the plan could not operate effectively and therefore it is a necessary part of the plan, determination of this issue would require a more thorough factual analysis than is possible based on the information contained in your request or available at this time. For example, other proposed PPOs that involve price setting through some mechanism other than agreement among competing participating providers apparently are being or have been formed. The existence and feasibility of such plans could undercut your "necessity" argument regarding this aspect of the plan. However, the Supreme Court's reasoning in the cases discussed above may permit you to seek to demonstrate that the proposed price-setting mechanism in fact significantly enhances efficiency, although other plans can operate without such a mechanism.

6/ For example, the financial contribution to your client's PPO, while $10,000 for each shareholder, could represent a contribution of less than $100 per individual physician.

7/ J. Paul McGrath, while Assistant Attorney General for the Antitrust Division of the Department of Justice, stated that in his view, efficiency-enhancing integration sufficient to avoid Maricopa's *per se* rule could flow from the following aspects of a provider-sponsored PPO's operations, among others: an agreement among the physicians to accept discount fees with no balance-billing of patients; utilization review by the PPO; joint marketing or PPO administration of claims; and an agreement by a panel of limited size to bid for contracts against other such groups. Remarks of J. Paul McGrath before the American Bar Association Antitrust Spring Meeting 7-8 (March 22, 1985).

In addition, if the proposed price-setting arrangement were a vital part of an arrangement creating a new product or substantial procompetitive efficiencies, a determination that the conduct would be legal would still require a finding under the rule of reason that the new competition created by the venture outweighed the competition among its participants necessarily restrained by the venture. In this respect, of course, your claim that the plan would lack market power is particularly relevant. 8/

In conclusion, for the reasons explained above, we lack sufficient information to determine the degree of difference in critical respects between your plan and plans like that condemned in Maricopa, or whether these differences would be sufficient to justify the proposed price-related agreements. Therefore, we are unable to supply you with the requested advisory opinion. We wish to emphasize that this conclusion should not be interpreted as a determination that your client's proposed conduct would be illegal or that the Commission would likely challenge the conduct. Rather, this conclusion reflects our inability to make a determination, from the facts given or available, as to the legality of the proposed conduct.

Sincerely,

M. Elizabeth Gee

M. Elizabeth Gee
Assistant Director

8/ An official of the Antitrust Division of the Department of Justice has indicated that a provider-sponsored PPO having as members fewer than 20% of actively practicing physicians in a market would be unlikely to raise antitrust issues relating to foreclosure of competition from other PPOs. Id. at 8-9.